No. 90-1029

In The

Supreme Court of the United States

October Term, 1990

EASTMAN KODAK COMPANY,

Petitioner,

vs.

IMAGE TECHNICAL SERVICE, INC., J-E-S-P CO., INC.; SHIELDS BUSINESS MACHINES, INC.; MICROGRAPHIC SERVICES, INC.; MICRO MAINTENANCE, INC.; ATLANTA GENERAL MICROFILM CO., INC.; ROGER KATONA, d/b/a G. & S. ELECTRONICS; AMTECH EQUIPMENT MAINTENANCE, INC.; ADVANCED SYSTEMS, INC.; BOB INGLE INC.; DATA PROX EQUIPMENT CO.; FISHER MICROGRAPHICS, INC.; I.O.A. DATA CORP.; SEARLE ENTERPRISES, d/b/a MICRO IMAGE INC.; MIDWEST MICROFILM EQUIPMENT & SERVICES, INC.; OMNI MICROGRAPHIC SERVICES INC.; AND CPO, LTD.,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENTS' SUPPLEMENTAL BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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RESPONDENTS' SUPPLEMENTAL BRIEF

This supplemental brief is submitted by respondents pursuant to Rule 15.7 of the Rules of this Court in reply to the *amicus curiae* brief filed by the United States.

INTRODUCTION

The Solicitor General argues that certiorari should be granted in this case because all that is complained of is "proper competitive behavior". Solicitor General's Brief ("S.G. Br.") at 17. However, because the District Court granted summary judgment after allowing only one limited set of interrogatories, one limited request for

documents and six depositions (and after denying further discovery), Pet. App. 36B-37B, Br. in Opp. 4-5, there is no factual or theoretical basis for concluding that Kodak lacks power in the parts or service markets, or that the restrictions Kodak imposes on the sale of replacement parts constitute proper competitive behavior. The record shows otherwise.

I. THE LIMITED RECORD BELOW DEMONSTRATES THAT, CONTRARY TO THE ASSERTIONS OF THE SOLICITOR GENERAL, RESPONDENTS' CLAIMS OF KODAK POWER IN THE PARTS MARKET CANNOT BE REJECTED AS A MATTER OF LAW

The Solicitor General seems convinced that respondents' market power argument is "inherently implausible", because respondents supposedly conceded below that potential equipment buyers "consider the cost of parts and service when initially deciding between Kodak's equipment and its competitors' equipment." S.G. Br. 3. The Solicitor General then argues that this concession means not only that Kodak equipment customers are not "locked in", but also that Kodak cannot set its prices for parts and service without regard to the effect of those prices in the interbrand equipment market. *Id.* at 11.

The Solicitor General cites the Ninth Circuit's majority opinion for respondents' supposed concession. Pet. App. 8A. The supposed concession was also relied upon in Judge Wallace's dissent. *Id.* at 20A. However, neither opinion cites any source for the purported concession. Both opinions are mistaken, because there was no such concession in the record below. In the proceedings before the District Court, respondents challenged the assumption that equipment buyers consider the costs of parts

and service before making their purchases in the basic equipment market. This was done through the declaration of the president of respondent Image Technical Services, Inc.[1] It is apparent from reading the Solicitor General's brief that this is a fundamental misapprehension about the record below.[2] Now that it has been corrected, respondents believe it obviates any need for review by this Court.

However, the Solicitor General may also be saying that even if respondents do not concede that customers consider the cost of parts and service before they purchase equipment, it is still so implausible that information about aftermarket costs would not be taken into account at the time equipment is purchased that respondents should not be given the opportunity to develop contrary evidence. If that is what the Solicitor General is

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[1] Paragraphs 61 and 62 of the declaration of Paul Hernandez, president of Image Technical Services, Inc., provide in full:

> 61. From my experience at Kodak and ITS, customers, including the Instant Copy Service which I am a partner in, do not go through a life cycle cost analysis for machines before purchasing the machines.
>
> 62. In some cases, like Federal government agencies, different departments purchase micrographics and photocopy equipment from the departments who pay for the service. The Department of Defense purchases equipment for the Air Force. Yet when service is ordered from ITS for McClellan Air Force Base micrographics and photocopy machines, the base buy[s] and pays for that service separate from its machine purchases.

See also footnote 4, *infra*.

[2] Rule 15.1 of this Court urges respondents to highlight perceived misstatements of fact that have a bearing on what issues are properly before the Court if certiorari is granted.

advocating, he is really seeking the adoption in the abstract of "Chicago School" ideology. This is an approach that is contrary to real-world facts, existing law and competing economic theories. Spivack, The Chicago School Approach to Single Firm Exercises of Monopoly Power: A Response, 51 ANTITRUST L.J. 651 (1983) (hereinafter "Spivack").[3]

Even if this Court were to consider it appropriate to supplant established law with Chicago School theory, it should not do so on the limited record below. That is because there are at least two circumstances in which even proponents of the Chicago School might concede that market power could be exercised in parts and service aftermarkets for a single brand of equipment. The first such situation is where the basic equipment market is oligopolistic. In a basic equipment market in which there is tacit collusion among a few large firms, there may be an economic incentive for the firms to avoid competitive pricing as to parts and service for their respective products. P. Areeda, 6 Antitrust Law ¶ 1432b2 (1986). Such tacit collusion to facilitate the firms' power in their respective aftermarkets is plausible and should be open to proof.

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[3] The Chicago School has adopted as an item of belief "that the market will adequately discipline non-profit maximizing conduct . . . [I]f conduct is not profit maximizing, it is 'self-deterring,' and . . . there is therefore no reason for 'trundling out the great machinery of antitrust enforcement' to prevent it. This assumption is nothing but an intuitive value judgment that the cost of enforcing the antitrust laws is always greater than the damage inflicted on the economy by conduct that is not profit maximizing." Spivack at 671 (citation omitted).

The second situation where market power might exist under Chicago School assumptions is where significant numbers of equipment buyers receive imperfect information about costs in parts and service aftermarkets. In such a situation, market power can exist, at least in the short run. That possibility exists here, because respondents demonstrated below that (1) Kodak changed its parts policy in 1985-86, so that customers who bought Kodak equipment before then could not have known that a tie would be imposed,[4] and (2) it is difficult even today for customers to conduct life-cycle costing before they decide which brand of equipment to purchase.[5]

If, as respondents have alleged, Kodak has power through replacement parts to foreclose competition for the servicing of Kodak machines, and has used that power with the purpose and effect of bringing about such

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[4] In footnote 11 of his brief, the Solicitor General appears to misapprehend the facts and the significance of the *parts* sales contract (which is separate from the *equipment* sales contract and is not seen by equipment buyers). The crucial point is not that post-1986 *parts* contracts may clearly spell out Kodak's restrictive parts policy (even assuming equipment buyers see such contracts), but that parts contracts before 1986 not only failed to spell out Kodak's restrictive parts policy, but stated exactly the opposite: that parts were available to all buyers, including ISOs. Declaration of Paul Hernandez, paragraph 15.

[5] Thus, the Solicitor General errs when he asserts that the opinion below relied upon unspecified market imperfections. S.G. Br. 8-9. Evidence of unusually large profits in the parts and service aftermarkets would also be relevant to the possibility of Kodak market power in these aftermarkets. Pitofsky, New Definitions of Relevant Market And The Assault On Antitrust, 90 COLUM L. REV. 1805, 1848-49 (1990).

foreclosure, there is cognizable injury and discovery should proceed in this case without further delay.[6]

II. THE DECISION BELOW IS NOT INCONSISTENT WITH ESTABLISHED TYING LAW, NOR IS IT A SUITABLE VEHICLE FOR CONSIDERING THE EFFECT OF LOCK-INS ON TYING CLAIMS

In addition to his general attack upon the Ninth Circuit's discussion of market power, the Solicitor General argues that the decision below cannot be squared with the framework for analyzing tie-in claims set forth in *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2 (1984). The Solicitor General asserts that the decision below "reads the substance out of the market power requirement of *Hyde*," and further represents an unwarranted extension of the holding in *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985), that a "lock-in" can enhance the seller's market power for the tying product. S.G. Br. 12-15.

Neither of these arguments withstands scrutiny. It is evident from the Court of Appeals' opinion that it understood a *per se* tying claim requires a showing of market

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[6] As Spivack observes:

> The tie-in or leverage area is one in which Chicago School theory comes into clear conflict with some of the principal non-economic goals of antitrust – preserving a deconcentrated industrial structure, dispersing economic power, and providing free access to markets. By engaging in an effective tying arrangement, a monopolist can drive equally or even more efficient competitors in the tied product market out of business.

Spivack at 663-64.

power for the tying product. Pet. App. 4A, 7A. The Ninth Circuit found that on the limited record before it, respondents had presented sufficient evidence to withstand summary judgment on this issue, because they adequately demonstrated that (1) Kodak parts are unique, and (2) the power of this uniqueness is enhanced by the fact Kodak equipment customers are "locked in" to Kodak for replacement parts. *Id.* at 7A-8A, 10A-11A. This conclusion is consistent with the ruling in *Hyde* that market power can be established by showing that the tying product is unique, 466 U.S. at 17, and with the ruling in *Digidyne* that the tying product's market power can be enhanced through a "lock-in", 734 F.2d at 1342-43.

The Solicitor General also faults the Ninth Circuit's tying conclusions because (1) they are based upon complaints by a "a handful of objecting customers", and (2) they ignore the constraints allegedly imposed by competition in the interbrand equipment market on a manufacturer's exercise of power in the replacement parts market. S.G. Br. 13-14.

The first complaint is based more on wishful thinking than on a sound reading of precedent. The language about "a handful of objecting customers" comes not from a decision of this Court, but from the First Circuit's decision in *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792 (1st Cir. 1988). It must be read in light of that court's holding that objections to overinclusive parts kits by only 3 of 64 affected auto dealers did not suffice, standing alone, to prove market power, 858 F.2d at 797-98. Neither *Grappone* nor any other case, however, establishes a rule that complaints by customers are not probative evidence of market power. After all, it is through such complaints that a tie-in is often proven. If

respondents had been offered more discovery in the District Court, they might well have found enough other objecting Kodak customers to satisfy even the Solicitor General.

To the extent the Solicitor General is suggesting that certiorari should be granted in this case to examine the lock-in concept, S.G. Br. 14-16 & fn. 16, it is apparent that better cases exist for that purpose than this one. For example, in the *Virtual Maintenance* case now pending in the Sixth Circuit, Pet. App. 43E, a jury found that Prime Computer violated section 1 of the Sherman Act by tying software upgrades to the purchase of hardware maintenance service from Prime (which has less than a dominant share in the market for sale and service of computers). In *HyPoint Technology*, also pending before the Sixth Circuit (*id.*), Hewlett Packard was found to have monopolized the market for maintenance of its brand of minicomputers, even though it has less than a dominant share in the market for sale and service of all computers. Either of these cases would permit the Court to review the market power issues raised by this case on a full trial record, rather than on the meager record that resulted from the premature grant of summary judgment here.

III. THE THINNESS OF THE RECORD MAKES THIS AN UNSUITABLE CASE FOR CONSIDERING THE ROLE OF SUMMARY JUDGMENT IN ANTITRUST CASES

The Solicitor General's final reason for urging that certiorari be granted is that this case "presents an appropriate occasion to emphasize the critical role of summary judgment in antitrust litigation." S.G. Br. 16.

Of all the Solicitor General's reasons for granting certiorari, this is the weakest. If, as the Solicitor General asserts, procompetitive and anticompetitive behavior can appear "indistinguishable" when "judged from a distance", *id.*, then that is an argument for having full discovery – including expert economic testimony – before summary judgment is considered. Without such a record, one cannot tell whether Kodak or any other party has engaged in "proper competitive behavior." *Id.* at 17.

The Solicitor General's argument finds no support in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). That was a case in which, after "several years of detailed discovery" (*id.* at 578), plaintiffs were able to produce only indirect, circumstantial evidence of the alleged predatory pricing conspiracy. Because permitting an inference of conspiracy to be drawn from such evidence might "deter procompetitive conduct", *id.* at 593, this Court held that the plaintiffs were required to "come forward with more persuasive evidence to support their claim than would otherwise be necessary." *Id.* at 587.

This case, unlike *Matsushita*, alleges mainly unilateral conduct by Kodak. But even in cases where *Matsushita's* relevance is unquestioned – i.e. in conspiracy cases where the only evidence of conspiracy is circumstantial – it has not been read as permitting summary judgment for defendants

> whenever the court concludes that inferences of conspiracy and inferences of innocent conduct are equally plausible. Allowing the district court to make that decision would lead to a dramatic judicial encroachment on the province of the jury.

In re Coordinated Pretrial Proceedings In Petroleum Products Antitrust Litigation, 906 F.2d 432, 438 (9th Cir. 1990), *cert.*

denied, No. 90-1552 (June 3, 1991). Rather, where the defendant's conduct is consistent with lawful behavior as well as conspiracy, summary judgment can be granted only if "permitting an inference of conspiracy would pose a significant deterrent to beneficial procompetitive behavior." *Id.* at 440.

Under this interpretation of *Matsushita* – which this Court declined to review only a few days ago – a full record with sufficient expert testimony to make the necessary economic determinations is obviously required. In this case, where the evidence developed thus far is conceded to be as consistent with the existence of market power as with its absence, S.G. Br. 17, an equally full record is required and summary judgment was inappropriate.

CONCLUSION

The arguments for granting certiorari here are based upon a misperception of facts and -- in view of the sparse record below -- upon "speculation" about "as yet undiscovered and unidentified facts". *Id.* It is these which form the basis for the Solicitor General's conclusion that Kodak's practices are lawful. Certiorari should accordingly be denied.

Respectfully submitted,

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